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ORIGINAL

October 30, 2001

BY HAND DELIVERY

Paul Margie, Esq.
Office of Commissioner Copps
Federal Communications Commission
455 12th Street, S.W.
Washington, DC 20554

Re: WT Docket No. 01-14: Written Ex Parte Presentation

Dear Paul:

Thank you again for taking the time to meet with us, on behalf of Leap Wireless International, about the CMRS spectrum cap. As always, we appreciate your time and your thoughts.

At our meeting, you asked four questions, and requested that we supplement the record on these questions, or point out where in the record the answers exist. Specifically, you asked: (1) Why doesn't the amount of money a firm pays for spectrum force the firm to put that spectrum to its most efficient use? (2) Does meaningful competition exist in CMRS? (3) Does such competition justify the relaxation or elimination of the spectrum cap? (4) Why isn't case-by-case merger review by DOJ adequate to prevent anticompetitive consolidation. We address each of those questions in turn.

I. THE COST OF SPECTRUM DOES NOT NECESSARILY FORCE ITS MOST EFFICIENT USE

Leap demonstrated through the declaration of Mark Kelley, its Chief Technical Officer, that carriers are not using the spectrum they have efficiently. Through a variety of means, carriers could realize dramatic increases in their system capacity. For example, Mr. Kelley shows that using the latest equipment (CDMA 1xRTT), Leap is able with 10 MHz of spectrum to realize a system capacity that would require 32 MHz of spectrum on a TDMA system, 78 MHz on a GSM system, or 164 MHz on an analog system.[1] Likewise, more

[1] Kelley Dec. ¶ 27.

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incremental modifications – such as enhanced vocoders, antenna diversity and cell-splitting techniques – can dramatically increase capacity without requiring a change in system technology.[2] This evidence has gone unchallenged: opponents of the spectrum cap concede that additional system capacity can be added either through the use of additional spectrum, or through technological improvements. But they contend that the spectrum cap artificially forces them to invest in technology, at the expense of equipment.[3]

In many settings, CTIA's point would have some validity. The carrier choosing whether to spend money on equipment or spectrum would typically choose optimally: the price of spectrum will account for its value to the next best alternative use (i.e. the next highest offer), and only if equipment is more costly than spectrum will the carrier choose to buy spectrum. Here, however, the carrier's choice is skewed by spectrum scarcity.

Because spectrum is both scarce and essential, a carrier choosing to invest in spectrum, rather than equipment, will reap an additional profit as his spectrum acquisition forecloses competitive entry. A hypothetical incumbent, "DeBeers Wireless," could pay $30 million for 10 MHz of additional spectrum in a given market, or $25 million for new cell sites and equipment. The optimal and socially desirable result would be for DeBeers to invest in equipment, not spectrum. But by paying the $30 million for spectrum, DeBeers would also prevent Leap from entering the market and driving down the prices DeBeers can charge – a price decrease that could easily wipe 37 percent off its gross revenues.[4] Plainly DeBeers would choose to invest in spectrum, rather than equipment: the additional expense of spectrum would be more than offset by the anticompetitive rent it could continue to extract.[5] The overall scarcity of one essential input makes CMRS peculiarly susceptible to cartelization, and prevents market forces from acting as they would in a perfectly competitive environment.

Because the CMRS marketplace is partially insulated from market forces, market forces cannot be relied upon to achieve the socially desirable result. The spectrum cap is necessary to ensure that spectrum holdings are used optimally.

II. MEANINGFUL COMPETITION DOES NOT EXIST IN CMRS.

As an initial matter, the nature of the CMRS marketplace necessarily renders it subject to anticompetitive behavior. As Dr. Cramton states, "[e]ntry costs in the CMRS industry are not only high, as in most other industries prone to monopolization, but *infinite* once all

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[2] Kelley Dec. ¶ 52.

[3] *See, e.g.*, CTIA Comments at 30.

[4] *See* Cramton Dec. ¶ 23 (demonstrating 37% price decrease between Leap markets and non-Leap markets).

[5] *See* Cramton Reply Dec. ¶¶ 46-47 .

spectrum is allocated."[6] Because the marketplace is not disciplined by the threat of entry, a range of anticompetitive conduct is possible that would be otherwise constrained by market forces. As Judge Posner points out, even in a market with a hundred participants, each fully producing a great quantity of output, an absolute barrier to new entry would permit any one of those hundred producers to exercise monopoly power in the true sense.[7] Because such a barrier to entry exists in CMRS, "the Commission cannot expect market forces alone to protect wireless consumers to the same degree as the spectrum cap has done."[8]

But of course, there are not a hundred producers of CMRS. Or even ten. Using independently-gathered data, Dr. John Hayes calculated the HHIs for the top 25 wireless markets in the United States. He discerned that, though the marketplace continues to become less concentrated, still the average HHI in those markets was 2611: well above the level considered to be "highly concentrated" by antitrust authorities.[9]

Even if one considers market share numbers based on the number of competitive alternatives available – that is, spectrum that is built out and operating – rather than on actual subscribership, still the marketplace is shown to be highly concentrated. CTIA's own experts calculate concentration of spectrum holdings for the top 10 MSAs based on spectrum that is built, and show that the average spectrum-based HHI is 1,916: still well within the zone considered "highly concentrated."[10]

The price and service offerings of incumbent carriers reflect this level of concentration. Prices appear to remain well above marginal costs, and the addition of incremental carriers continues to produce measurable price decreases.[11] And the incumbent carriers have established price points and service offerings that fail to appeal to 61 percent of

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[6] Cramton Dec. ¶ 16.

[7] Richard A. Posner, *Economic Analyses of Law*, 3d ed., 262 (1986)

[8] Cramton Rep. Dec. ¶ 17.

[9] Hayes Dec. ¶ 18 (attached to Sprint Comments).

[10] Schwartz & Gale Dec. at Table 2. Moreover, the logical basis of Schwartz and Gale's calculations is flawed. The question in determining whether competition enforcement is necessary is not what concentration levels exist *prior* to a contemplated transaction, the question is what concentration levels *would* exist *after* that transaction. The transfer of 10 MHz of spectrum to a carrier with 45 MHz would give that carrier (with 55 MHz post-transaction) approximately 30 percent of the overall spectrum holdings (up from 25 percent), and would thereby increase that firm's share of the HHI by approximately 300 points.

[11] *See* Cramton Dec. ¶¶ 25-34.

Americans.[12] This cannot constitute "meaningful economic competition" that would render regulation superfluous.[13]

III. THE CAP HAS NOT BEEN RENDERED "NO LONGER NECESSARY".

The Biennial Review does not ask whether competition exists, or whether it exceeds some specified level. The review asks whether any regulation "is no longer necessary in the public interest as the result of meaningful economic competition."[14] The question then, is whether competition is able to achieve the ends that had been sought by the cap.

A good example of a regulation that truly was rendered unnecessary by competition was the requirement that AT&T file ARMIS reports.[15] The purpose of these accounting reports had been to prevent AT&T from artificially shifting costs from competitive markets into regulated (monopoly) markets. Once competition existed in the formerly monopoly market, ARMIS reports were no longer necessary because there were no captive ratepayers onto whom AT&T could shift costs. In that competitive environment, then, competition had achieved the ends of, and had obviated the need for, those accounting regulations.

There is no doubt that competition has not achieved the ends sought by the spectrum cap. The existence of several carriers would not by itself prevent consolidation and the "excessive concentration of licenses."[16] Nor does the existence of multiple carriers promote innovation and diversity[17] by ensuring that relatively more spectrum remains available for new entrants. Nor, as discussed above, do current levels of competition ensure the "efficient and intensive use" of spectrum.[18] No development in the CMRS marketplace has obviated the need for the cap.

IV. THE FCC CANNOT RELY ON DOJ REVIEW.

Some of the largest wireless incumbents have urged the FCC to refrain from all pre-merger review. Cingular, for example, urges the Commission to "eliminate the spectrum cap

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[12] Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, *Sixth Report*, FCC 01-192 (rel. July 17, 2001) ("*Sixth CMRS Report*").

[13] *See* 47 U.S.C. § 161(a)(2).

[14] 47 U.S.C. § 161 (a)(2).

[15] *See* Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271 ¶ 12 (1995).

[16] 309(j)(3)(B).

[17] *Id.*

[18] 309(j)(3)(D).

and defer to the antitrust analysis conducted by DOJ."[19] As a policy matter the Commission should not do so, and as a legal matter the Commission cannot.

First, the FCC is charged by statute with a different mission than the DOJ. Congress has required that the Commission seek in its regulations certain ends that are distinct from those sought by the DOJ in its pre-merger review. While DOJ will challenge mergers that tend to "substantially lessen competition," FCC must engage in a broader public interest review. Among other things the Commission must promote and "make available, so far as possible" communications services,[20] it must determine whether any transfer is in the "public interest, convenience, and necessity,"[21] it must promote "economic opportunity," it must ensure the "efficient and intensive use of the electromagnetic spectrum,"[22] it must prevent the "excessive concentration of licenses,"[23] and promote the development of "new technologies, products and services."[24]

Congress was serious when it imposed these requirements. Before it allowed the FCC to embark on the fundamentally free-market competitive bidding scheme by which it now allocates spectrum, some lawmakers expressed their belief that this "would violate the notion that the airwaves are owned by the public and should be regulated for its benefit . . . instead of selling spectrum rights to the rich."[25] More specifically for these purposes, Congress stated its "concern[] that, unless the Commission is sensitive to the need to maintain opportunities for small businesses, competitive bidding could result in a significant increase in concentration in the telecommunications industries."[26]

The OBRA, then, was the product of a compromise. Congress approved the essentially free-market allocation mechanism that is used today, but at the same time required that the Commission exercise its regulatory authority to achieve certain specified ends. Even if it would prefer to rely solely on free-market spectrum allocation, the Commission cannot abdicate its responsibility to pursue the regulatory ends set out in the Communications Act.

Moreover, there are many reasons that DOJ is systematically unsuited to accomplishing the review that the cap now affords. As an initial matter, the Hart-Scott-Rodino filing thresholds – now $50 million – would insulate most pure spectrum acquisitions from DOJ

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[19] Cingular Comments at 34.

[20] 47 U.S.C. § 151.

[21] 47 U.S.C. § 310(d).

[22] 47 U.S.C. § 309(j)(3)(D).

[23] 47 U.S.C. § 309(j)(3)(B).

[24] 47 U.S.C. § 309(j)(3)(A).

[25] 139 Cong. Rec. S1437 (daily ed. Feb. 4, 1993) (statement of Sen. Inouye).

[26] H.R. Rep. No. 103-111, at 581 (1993).

review: 80 percent of the licenses sold in Auction #35 fell under that threshold, and would have escaped review in a private transaction. 66 percent of those licenses sold for less than $10 million, and thus they would have escaped review even if aggregated in blocks of 5 or more.[27]

Likewise there are institutional limits on DOJ review. Consistent with its statutory mandate, DOJ focuses on actual competition, generally to the exclusion of potential competition (such as the sort of new entry that the spectrum cap is intended to preserve). DOJ lacks inherent authority to block mergers, but must go to court as would any other litigant. And DOJ is overworked and understaffed. In 1999, for example, fewer than five percent of all pre-merger notifications received "second requests."[28] And DOJ filed suit in less than one-half of one percent of all reportable transactions.[29] The Antitrust Division stated in its most recent Annual Report: "The analysis of proposed mergers has become increasingly difficult as the products and services of our economy become more complex and the pace of development of new products increases."[30] The Antitrust Division is not prepared to review every spectrum acquisition to determine whether it is likely to foreclose competition.

Nor would case-by-case review of mergers by the FCC be a good substitute for the spectrum cap. The spectrum cap provides ex ante certainty, allowing parties to greater freedom to structure their affairs. And it facilitates both the primary (auction) and secondary (resale) markets for spectrum licenses by allowing both spectrum sellers and competing bidders to identify the pool of eligible buyers. The cap provides a two-tiered mechanism that minimizes the overall weighted error costs to society by looking first to easily identifiable structural characteristics, and then moving only rarely to a more comprehensive analysis. And it greatly reduces the administrative costs to the Commission, and to the industry – including parties to the proposed merger as well as competitors, who are often required to produce information in a comprehensive merger analysis.

A bright-line rule such as the spectrum cap is paradoxically *de*regulatory, as it removes discretion from staff and individual decisionmakers who might otherwise be tempted to use that discretion to promote pet causes, or other ends that are unrelated to the purpose of the pre-merger review. Chairman Powell has criticized the Commission's exercise of discretion in case-by-case reviews, often focusing on "tendency to adopt conditions that were divorced from

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[27] *Public Notice*, C and F Block Broadband PCS Auction Closes, DA 01-211, Attachment A (rel. Jan 29, 2001).

[28] *See* Antitrust Division, United States Department of Justice, *10- Year Workload Statistics FY 1990 – 1999*, available at http://www.usdoj.gov/atr/public/4504.htm (site accessed April 12, 2001).

[29] *Id.*

[30] Antitrust Division, United States Department of Justice, *Annual Report FY 1999*, available at http://www.usdoj.gov/atr/public/4523.pdf (site accessed April 12, 2001) at 9.

the perceived harms."[31] Such problems are associated with the exercise of regulatory discretion, and as such case-by-case review is inherently more prone to these problems than is a bright line rule such as the cap. For all these reasons, Leap firmly believes that the spectrum cap remains in the public interest.

By copies of this letter to the Secretary I am filing this as an *ex parte* presentation in the above-captioned proceeding.

Very truly yours,

James H. Barker
William S. Carnell
of LATHAM & WATKINS

cc: Magalie Roman-Salas (two copies)
Peter Tenhula
Bryan Tramont
Monica Desai
Jeffrey Steinberg
Lauren Kravetz
John Branscome

[31] Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations by Time-Warner Inc. and America Online Inc., Memorandum Opinion and Order, FCC 01-12 (rel. Jan. 22 2001) (separate statement of Commissioner Powell).